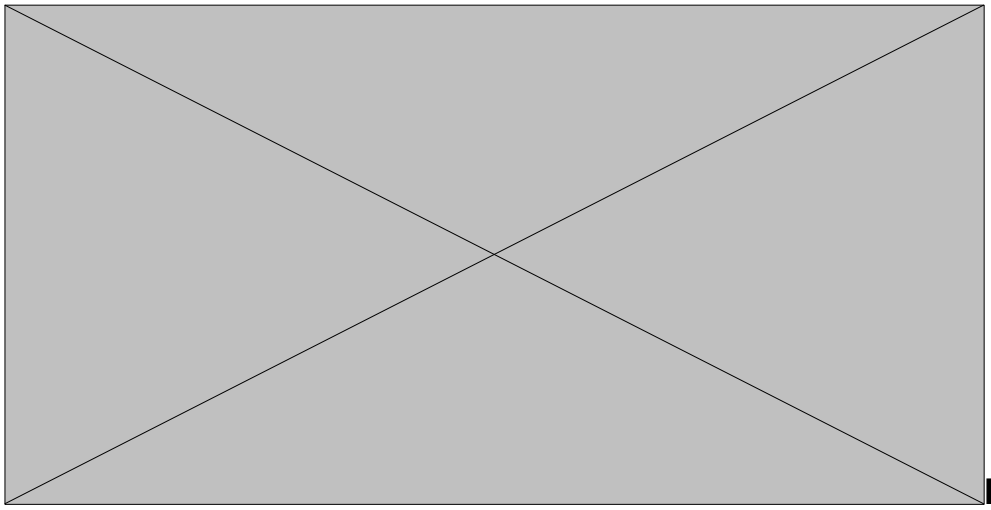

BEFORE

THE
SENATE COMMITTEE ON COMMERCE,
SCIENCE & TRANSPORTATION

HEARING ON
TRANSITION TO HDTV

Statement of
Alan McCollough
President and COO
Circuit City Stores, Inc.

July 8, 1998
9:30 a.m.

On behalf of Circuit City Stores, I would like to thank you, Mr. Chairman, for inviting me to appear on this distinguished panel.

Circuit City is the nation's largest retailer of brand name consumer electronics and appliances, and a leading retailer of personal computers and music software. We have 562 stores in 44 states, including 502 Circuit City Superstores, 52 Circuit City Express stores, and 4 “electronics-only” stores. Circuit City currently employs over 40,000 associates. We had more than $8 billion in retail sales in 1997.

Circuit City has a great interest in the transition from analog to digital television. Our stake reflects that of our customers. Because we can only sell what the customer is willing to buy, we must provide a compelling offer that causes our customers to appreciate and embrace the transition to digital television and services. If we can provide such a compelling offer, Circuit City and hundreds of other retailers will prosper, and we will provide for the most expedient return of the analog broadcast spectrum.

We believe the speed of the transition to digital television is tied to three critical factors: (1) extraordinary picture quality; (2) competition in offering multi-function digital set-top devices that include the ability to convert cable signals for display on analog televisions; and (3) digital television signal delivery.

(1) <u>Extraordinary Picture Quality</u>

We are on the brink of a revolution, not mere progress, in the clarity, detail and viewing experience that can be achieved in home television. Customers will respond enthusiastically to products that, when properly

presented, are clearly new and significantly better--what I refer to as the "Gee Whiz" factor.

Customers do not know to ask for something they have never imagined, seen or heard. But once they see something dramatically better in the store, in the house next door, or on the next channel, then we believe that is what they will want.

We have a great deal of experience in introducing new consumer electronics, computers, and home appliance products. We are, for example, the nation's largest seller of "DSS®," the first consumer digital video satellite delivery system. No recent product introduction, however, has had close to the potential impact of digital television.

In our opinion, the only presentation of digital television that will create the necessary consumer excitement is full wide-screen high definition television (HDTV). This is not based on any notion that consumers buy formats or descriptions. What will entice our customers is a dramatic breakthrough in picture performance. If television programming is originated, transmitted, and presented with the HDTV viewer in mind, the combination of panorama and detail will indeed be breathtaking.

On major league baseball's opening day, we had the opportunity to display the first HDTV broadcast of a live sporting event in two of our Dallas area stores. A continuous crowd of several hundred people on a Tuesday afternoon was clear evidence of the great consumer interest in HDTV. The

extraordinary crowd reaction made it obvious that customers knew they were seeing something very special. We are excited that this fall we will be able to replicate the Dallas experience in a much larger number of our stores.

Our customers deserve and will want the best picture that the consumer electronics, computer, broadcast, transmission, and retail industries can provide. The public policy objective here ought to be to ensure that the broadcasters use any of the additional spectrum entrusted to them, which they choose to retain, for the purpose of providing a full HDTV picture. Let us not settle for anything less than the very best before the transition has even begun and let us not be so presumptuous as to decide that anything less than the best is "good enough" for our customers.

Some will argue that presenting the best picture resolution will make HDTV sets too expensive. We would suggest that even a brief review of the history of rapidly declining prices in the consumer electronics industry would make it clear that any such argument is without merit. If anything, the pace of product improvement and cost reductions is significantly faster in the digital world than anything we have previously experienced in the analog world. Every day we read about new performance breakthroughs in digital devices combined with substantially lower cost. We believe any decision to preclude offering the customer the best based on today's cost would be shortsighted.

(2) <u>The Multi-Function (Set-Top) Box</u>

We believe that the TV set used in the home's primary viewing area is an early candidate for replacement by a new HDTV set. For the digital transition to be successful, however, we must also provide a compelling reason for customers to enable the other sets in their homes to receive digital signals. We believe the capability exists in the digital environment to provide such a reason.

Digital technology makes possible a high level of product integration and compatibility that currently does not exist. A digital television, a digital video disc (DVD) player, a digital cable box and a digital satellite system all apply common signal processing techniques: they decode and decompress signals that are part of an industry family of standards known as "MPEG2." In fact, 70% to 80% of the componentry and circuitry is common among all of these digital video devices. Consequently, multifunction devices, which would offer great convenience for the customer, can be produced at little incremental cost. We will no longer have to challenge the customer to see how many boxes they can stack upon their television set. One MPEG2 decoder per television is all that is required.

Although we expect a wide variety of integrated digital set-top devices to be made available, the greatest utility will come from those that include cable functionality. The Congress, in 1996, and the FCC, a few weeks ago, took major steps to make such a combination possible. Until these recent actions, the cable "set-top box" remained exempt from the competitive forces that have reduced the price and enhanced the features and functionality of consumer electronics and

computer devices. Because these boxes contained system specific “secrets” that helped control access to particular programming, they could only be provided by local cable operators.

In its Report and Order dated June 11, 1998, the FCC required that, in the future, the proprietary circuits heretofore contained in such devices be packaged instead on “Point of Deployment” modules (PODs) that, through a standard interface, can plug into televisions, VCRs, computers, and other products designed to function as “navigation devices.” By requiring a complete conversion to separate renewable POD modules, the FCC has insured that set-top converters will become staple consumer electronics and computer products open to the full competition, efficiencies, and price reductions that are the hallmarks of those industries. The significance of this change should not be underestimated.

With suppliers in the consumer electronics and computer industries free to configure and combine conversion features and functions as they wish, customers will have a field day. It will be the competitive manufacture, configuration and sale of these flexible consumer electronics and computer hardware and software products that will make digital television transmissions both desirable and affordable for every household well before the year 2006.

In this respect, Mr. Chairman, I would like to complement the cable television industry for accepting the challenge to create technical standards to assure the competitive availability of devices, and responding in a highly

constructive manner. Through its CableLabs research consortium, the industry has proceeded with a project called “OpenCable,” through which it is developing a set of specifications to enable and support the scenario that I have described. Our Circuit City technical staff has been pleased to cooperate with the CableLabs staff and has found such cooperation highly rewarding. We have every confidence that this project will play an important role in the transition to a competitive and successful digital future.

(3) Signal Delivery

The third factor crucial to a successful transition to digital television in general, and HDTV in particular, is signal delivery. This means that if broadcasters, as I hope they will, provide true HDTV signals, no intermediary should be in a position to degrade this experience when delivered to their customers. When it comes to broadcast resolution, cable service in particular must act as a conduit, not a filter or bottleneck.

More than two-thirds of American homes receive their television signal by cable wire. Thus, there will be little reason, and very little incentive, for broadcasters to invest to produce, originate, and transmit signals of the highest resolution if these customers are never going to see them presented in this way. Nor would their retail choices be very informed. Our customers should be able to enjoy at home what they can see in our stores. Simply put, the surest way to delay or derail the transition to digital television is to fail to make the signal

available in the same resolution in which it is originally broadcast.

We acknowledge that there are currently a number of bandwidth limited cable operators for whom carrying a full HDTV signal would present a short-term hardship. Those operators acknowledge that they have underserved customers and would require an infrastructure upgrade in order to add channel capacity. We recognize that investment capital is scarce, and that in the past cable operators might have been forced to choose between investments in new set-top boxes or infrastructure upgrades. In this respect, the new FCC rules on set-top boxes should be of considerable assistance. With competitive commercial availability now provided for through the retail distribution channel, cable operators should clearly be free to concentrate their efforts on making the necessary system upgrades. It is somewhat perplexing, therefore, to read about cable operators allocating billions of dollars to buy digital set-top boxes to lease to their subscribers. We recognize that system operators have a right to be in this business, and that some will want to stay with the old paradigm of device distribution for as long as possible. We would suggest, however, that when the Congress hears about shortages of investment capital for creating the necessary bandwidth, it should ask whether the complaining operators are allowing the competitive retail market to supply set-top devices to their customers

Not all of the existing rules, however, or even all of the laws, are written so as to provide the correct incentives for competition. We are concerned that some provisions actually provide cable operators with short-term incentives to

keep plowing money into their own boxes, and even to ask their customers to subsidize the least efficient ways to convert to digital technology. We are also concerned that, without continued vigilance by the Congress and the FCC, system operators may effectively discriminate against those customers who rely on the competitive model.

The 1996 Telecommunications Reform Act, in providing for competitive availability of navigation devices, explicitly stated that devices provided by cable system operators could not be subsidized by the charge for services. But in another provision, it allowed a subsidy for operator-supplied devices that is not available for devices that are purchased on the open market. Section 301(j) of that Act added a new Section 623(a)(7) to the Communications Act (47 U.S.C. § 543(a)(7)), requiring the FCC to allow cable operators to aggregate equipment costs into broad categories, so as effectively to require users of existing analog converter boxes to subsidize the lease of digital converter boxes to other customers. Moreover, the FCC regulations adopted on June 11, 1998, do not impose any overt controls on the prices that cable operators can charge owners of competitively purchased navigation devices for the PODs necessary to their operation with particular systems.

Having come this far, Mr. Chairman, in allowing competition to drive the transition to digital transmission, it would be a shame to see this competition held up by subsidies to non-competitive distribution, and by the pricing practices of system operators. We are convinced that device competition, if allowed to

gain a foothold, will afford the quickest, most efficient, and least costly consumer transition to HDTV. It will require continued vigilance by the Congress and the FCC, however, to assure that system operators do not use existing rules to spread costs rather than eliminate them, or to overcharge consumers who choose the competitive model.

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In conclusion, Mr. Chairman, the transition to digital television broadcasts, after so many decades of analog NTSC service, should not be viewed as an isolated exercise by one or two industries. The key is to serve and please the consumer. To do so will require broadcasters to transmit their very best signals, manufacturers to offer multifunction set-top devices which include cable functionality, and program distributors to deliver the very best signals.

The transition to high definition television will succeed if we maintain our focus on innovation and competition. We think our customers will buy the best if they are offered the best. The marketplace, if allowed to work for both signals and devices, ultimately will make the best affordable for everyone.

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